

# How to keep energy intensive industry competitive and avoid inefficient subsidy races

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**With the Clean Industrial Deal and the Affordable Energy Action Plan, the EU Commission wants to reduce energy prices in the short and long term - including through subsidies. This harbours risks, write Lukas Bertram (ZOE Institute for Future-fit Economies), Andreas Eisl (Jacques Delors Institute), Philipp Jäger (Jacques Delors Centre) and Philipp C. Verpoort (Potsdam Institute for Climate Impact Research).**

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Across the EU, politicians and interest groups are calling for quickly lowering energy prices to support struggling energy-intensive industries. At the EU level, the “Affordable Energy Action Plan”, proposed last Wednesday alongside the “Clean Industrial Deal”, presents the Commission’s thinking on how energy prices can be lowered in the short and long term, including by using public budgets.

While this approach has merit, it bears substantial risks if executed poorly: If some Member States heavily subsidize electricity prices while others won’t or can’t, costly distortions would be the most likely outcome, hampering both economic efficiency and climate efforts. The EU Commission, which has exclusive competence over state aid, must therefore now propose a policy framework that avoids distortions and drives investments for energy-intensive industries into regions with low long-term clean energy prices.

## **Electricity cost gaps will persist**

The price of electricity – the main energy carrier of the future – will come down in the EU over the next few years, as more renewables, storage, flexible demand, and grid integration between countries are added. However, large differences between electricity prices will remain: some EU regions with favorable wind and sun profiles will enjoy much cheaper electricity. Globally, the gaps will be even larger. Nuclear power will not change that dynamic much, as it will remain comparatively expensive.

As transporting electricity and clean hydrogen over long distances will continue to be expensive, cost gaps will persist. Subsidizing electricity prices indefinitely for uncompetitive industries is thus certainly not a desirable option.

## **A focused restructuring of value chains can be beneficial**

The ‘sweet spot’ for countries with prospectively higher electricity prices likely consists in importing intermediate products that are highly energy intensive, while keeping downstream parts of the value chains, which typically create more jobs and value-added. In other words: EU countries prone to high electricity and hydrogen prices can keep the steel industry, but should start importing clean iron sponge. Doing so not only improves companies’ overall competitiveness, but also frees up clean electricity to decarbonize non-tradable economic activities like domestic heating or transport.

## **EU policy must reconcile economic efficiency with climate and resilience objectives**

Therefore, the EU’s state aid rules need to strike a delicate balance: ensuring efficiency and avoiding subsidy races, while allowing subsidies that have large positive effects on climate and resilience. To accomplish this, the EU should allow state aid to energy-intensive industries that are at risk of losing global competitiveness only if at least one of these conditions is met:

1. **Temporary price peaks:** When electricity prices face a temporary peak (due to transformational costs or temporary shortages in supply), support for energy-intensive industries could be justified, if prices can be expected to fall back to a lower level under reasonable assumptions and within a short timeframe.
2. **Indirect benefits:** The relocation of energy-intensive industries either within or outside of the EU (e.g. the steel industry) could lead to substantial indirect economic losses, such as knock-on effects in downstream industries (e.g. in the automotive industry). In these cases, Member States willing to subsidize should be required to demonstrate the positive externality.
3. **Climate protection:** In some hard-to-abate sectors, the EU is uniquely positioned to scale up clean manufacturing technologies, thereby showcasing their feasibility and reducing their global cost curves along with emissions. Here, the Commission should define a list of goods and clean production technologies for which electricity price subsidies are generally permissible. To boost efficiency, these subsidies should be financed and allocated at the EU level, but where EU-level funds do not suffice, Member States should be allowed to use national funds (for instance via ‘auctions-as-a-service’).
4. **Resilience:** For a very small number of products, imports even from a diverse supplier base might cause excessively high resilience risks, justifying permanent subsidies. The Commission should define for which products this is the case, and, if their production is not competitive even in the most favourable EU regions, auction off production subsidies. This would ensure a base capacity remains, which could be scaled up in case of supply shocks.

EU regions with cheap clean energy may lack other conditions, such as a skilled workforce. But unlike sunshine and wind, policy can improve these conditions. The EU Commission should identify ‘high potential energy’ regions, and, with Member States and other stakeholders, implement a strategy for up- and reskilling of the workforce and building relevant infrastructure. In parallel, other instruments can cushion negative effects on workers in regions that face a loss of some industries.

With the approach suggested here, the EU has a genuine opportunity to harness the potential of its single market for a more competitive, resilient and sustainable industrial future.